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THE RELATIONSHIP BETWEEN COMPETITION, COMPETITIVENESS AND DEVELOPMENT

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Executive summary

The relationship between competition, competitiveness and development is receiving increased attention in the light of globalization and its implications for sustained economic growth and welfare. Policy makers in both developed and developing countries worry about national competitiveness and how to achieve it. In this context, the issues note highlights the changing nature of competition and its implications for achieving and sustaining competitiveness, and discusses some of the issues and policy implications facing Governments as they wrestle with competitiveness concerns in a globalizing world economy. Among the main policy issues identified by the note is that the competitiveness of developing country firms (and by extension of developing countries) to integrate into the world economy depends to a large extent on their acquiring the necessary capabilities to apply available technologies and innovate, and on the domestic availability of competitive supporting infrastructure (including human and financial resources and services). This implies policy measures beyond trade liberalization to address (i) supply capacities at the systemic level; (ii) concentration of market power, which is both an outcome of global competition and a threat to global competition; and (iii) the consequent need for the strengthened application of competition principles.

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INTRODUCTION

1. Recent developments in the global economy, including mega mergers and the increased potential for cross-border anti-competitive practices, are of direct relevance to developing countries' growth and development and have implications for their integration into the world economy. Evidence from the experience of developing countries over the past decade suggests that insufficient attention to competition issues has, in some cases, negated whatever positive effects may have been gained from liberalization and privatization.

2. These issues, in the light of the fact that the gains from globalization have been slow to materialize in developing countries, have brought to the forefront the interface between competition, competitiveness and development.

3. In the light of the above considerations, the Intergovernmental Group of Experts on Competition Law and Policy at its last session requested the UNCTAD secretariat to prepare a study on the relationship between competition, competitiveness and development for consideration at its fourth session.

4. Economists are generally not in agreement as to the applicability of the concept of competitiveness to a country.[1] Competitiveness is most meaningful and uncontroversial when applied to the individual firm, which is the principal agent for building competitiveness. For the purposes of this note, the term "competitiveness" is used with reference to the firm.

5. The present note seeks to shed light on the complex and changing association between competition and competitiveness and its implications for development. In this context, section I reviews the theoretical underpinnings of the concept of competition and the sources of international competitiveness. Section II highlights some of the main impediments with respect to fostering international competitiveness in developing countries, section III looks at how competition law and policy addresses anti-competitive practices in a developing country, and section IV examines the role of foreign direct investment (FDI) and export promotion in facilitating competitiveness, as well as the experience of developing countries in fostering competitiveness. Section V summarizes the policy conclusions and implications arising from the discussions.

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[1] Definitions of national competitiveness place emphasis on maintaining and expanding domestic real incomes. The OECD defines competitiveness as "the ability of companies, industries, regions, nations or supranational regions to generate, while being and remaining exposed to international competition, relatively high factor income and factor employment levels on a sustainable basis". Similarly, Scott and Lodge (1985) define national competitiveness as the ability of nation States to produce, distribute and service goods in the international economy in competition with goods and services produced in other countries, and to do so in a way that earns a rising standard of living. However, Krugman (1994) dismisses national competitiveness as a meaningless expression when applied to national economies and Porter (1990) is of the opinion that the only meaningful concept of competitiveness at the national level is national productivity.

I. COMPETITION AND COMPETITIVENESS

6. In a market economy, firms compete with each other to win consumers. Competition provides an incentive for firms to perform at their best, producing high-quality goods and services at the cheapest price. Competition encourages entrepreneurial activity and market entry by new firms by rewarding efficient firms and sanctioning inefficient firms. In ideal market conditions firms react flexibly and quickly to changing market demands and the relentless entry of new firms. The entry of new firms provides the necessary stimulus for adjustment, while the ability of firms to adjust, and the speed at which they do so, are a measure of their efficiency and, by extension, their competitiveness. Competition is thus a key driver of competitiveness.

7. However, in most markets, market conditions rarely approximate the ideal as prescribed by economic theory. In reality many barriers exist which preclude markets from being truly competitive, thus hampering firms' adjustment to changing market conditions and preventing new firms from starting up. Such barriers may result from various information asymmetries between competing firms relating to the market and technology, regulation, scale economies and the use of anti-competitive practices by firms already in the market to expand their control over others or to stop others from entering the market.

8. In its widest sense, competition connotes the "survival of the fittest" and it can therefore be said that competition kills competition. In the face of increased competition and in the pursuit of larger profits, existing market players can be tempted to distort or eliminate competition in order to acquire and abuse market power. Consequently, policy interventions are necessary in order to maintain and encourage healthy competition. In recognition of this need, Governments in many countries implement a competition policy to maintain and encourage healthy competition, which includes laws and policies dealing with anti-competitive practices.

9. Globalization and liberalization, facilitated by rapid advances in technology, are creating new dynamics of competition and, in so doing, render the determinants of competitiveness much more complex. As already established in the preceding discussion, greater efficiency is the source of competitiveness. In the context of international trade, competitiveness is traditionally defined in terms of exchange rates, costs and prices. Nowadays a distinction is drawn between static competitiveness and dynamic competitiveness.[2] In the former, the emphasis is on price competition whereby firms compete on the basis of received endowments such as low-cost labour and natural resources. Under these circumstances, retaining competitiveness is dependent on maintaining or lowering production costs. This is the basis on which many developing country firms compete. Dynamic competitiveness is associated with the changing nature of competition, which places a premium not only on the relationship between costs and prices but also on firm-level ability to learn, rapidly adjust to new market conditions and innovate (where innovation is defined in

[2] Also referred to by Pyke and Sengenberger (1992) as the "low" and "high" roads to competitiveness.

the broadest terms and is not necessarily confined to radical technological innovation).[3] In this framework, competitiveness refers to the ability of firms to produce goods and services that stand the test of international competition, while upgrading technological capabilities.[4]

10. With globalization and liberalization, the boundaries between national and international markets have become blurred, traditional distinctions between national and international competitiveness thus becoming redundant. This blurring of boundaries has implications particularly for small and medium-sized enterprises (SMEs), which were previously insulated from international competition by national borders. A lack of finance and insufficient technological capabilities limit the ability of even firms that were domestically competitive prior to liberalization to respond to competition that cuts too quickly into their market share. In underdeveloped markets with few participants, technological learning can be extremely risky and expensive for the individual firm and is often not undertaken in the absence of supporting policies to facilitate their adjustment.

11. A notable feature of the changing nature of competition is a radical alteration in the organization of firms as well as the organization of production, marketing and distribution of goods and services at the international and national levels. In order to adapt and remain competitive firms are exploiting externalities or "knowledge spillovers" through inter-firm cooperation. Access to and possession of knowledge, in addition to technical hardware, has become an important asset for global producers. Networking and being part of a production network is an increasingly important way in which firms get to "know-what", "know-how", "know-why" and know-who" in their particular line of business. The importance of innovation, and its research and development costs, has given rise to the duality of cooperation and competition.

12. An increasingly significant form of inter-firm cooperation and coping mechanism utilized by firms in the face of the new competition is mergers and acquisitions. Globalization, capital market pressures, the evolution of technical infrastructure required to support networking and the advent of the Internet have precipitated global industry consolidation. Among the industries in which this trend towards consolidation is documented are banking and financial services, cigarettes, petroleum products, airlines, telecommunications, chemicals, sport shoes, beverages, automobile production and food services. According to a recent study on the phenomenon,[5] at the end of the various stages of consolidation, the three largest market participants will typically have captured 70–80 per cent of the market.

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[3] The term "innovation" as used here corresponds to that defined by Ernst, Ganiatsos and Mytelka (1998), whereby innovation refers not only to innovation at the frontier of technology but also to continuous and incremental changes carried out by firms in the course of organizing investment, creating production capacity, building and upgrading technological capabilities and generally learning to cope with changes.

[4] It is now well established that technology is more than just technical hardware. In the new mode of competition, technology encompasses developing company strategy and implies a certain degree of managerial skills and organizational and process-related capabilities which can lead to continuous improvements in the way that existing technologies and resources are employed, thus deriving dynamic gains from static comparative advantages.

[5] Transnational Corporations Observatory (2002). See also WIR (2000: chapter V).

13. Although high concentration does not necessarily equate with a lack of competition and need not have a negative impact on economic performance, it does facilitate the exercise of market power and anti-competitive behaviour.[6] The duality between cooperation and competition is not only a justification for countries to develop and enforce competition policies, but it also demands increased vigilance and sophistication on the part of competition policy enforcement authorities to ensure that cooperation does not lend itself to anti-competitive behaviour by merged or networked firms, care being taken at the same time not to stifle innovation and, in so doing, competition and competitiveness.

[6] The experience of countries such as Japan and the Asian newly industrializing economies would suggest that international competitiveness can be achieved in the presence of domestic market concentration.

II. COMPETITIVENESS CONSTRAINTS IN DEVELOPING COUNTRIES

14. There is growing evidence that anti-competitive practices both at the international and the national level hamper the competitiveness of firms in developing countries. According to DFID (2001), available evidence suggests that anti-competitive practices in the international arena are more prevalent and pervasive in developing countries and impair the process of development. This is because developing countries have to rely heavily on imports in view of their narrow domestic industrial base, and to the extent that their imports are subject to anti-competitive practices, local producers and consumers are penalized by higher than necessary import prices. Similarly, developing countries' exports to countries where anti-competitive practices may exist undermines their export growth. Firms can engage, and tend to engage, in cross-border anti-competitive behaviour with impunity, especially in countries that do not have domestic competition law, and developing countries are particularly vulnerable to these practices. The majority of them have not as yet developed competition laws and policies. Even those countries that have done so face a number of resource and skill constraints in enforcement.

15. At the international level, perhaps the most pernicious anti-competitive practices that may have knock-on effects in more than one industry or market, emanate from cartelization. As globalization has intensified competition, there is an apparent sharp increase in global cartel activity, or at least in its detection, in recent years. For example, the Office of Fair Trading (United Kingdom) is reported to uncover cartels at an average rate of one a month.[7] Estimates of global cartel activity rely on the results of government investigations in developed markets. It is very likely that some international cartels escape detection because of the paucity of information about, and prosecutions of, cartel activities in developing countries. According to Evenett et al. (2002), the United States and the European Union prosecuted at least 40 private international cartels during the 1990s. Developing countries are estimated to have imported goods worth between US$42.8 billion and US$81.1 billion in 1997 from industries that had had a price-fixing arrangement during the 1990s.[8] Analysis of the impact of these imports suggests that they represented a larger fraction of trade for the poorest developing countries and that the consumption impact is largest for upper-middle-income countries.

16. Levenstein and Suslow's (2001) survey of cross-section studies of private international cartels clearly underlines the duality between cooperation and competition. It demonstrates the variety of techniques available to cartels for blocking entry into their particular industry. Even in cases where entry into an industry is fairly easy and a large number of firms are in fact active, various relationships among producers, either as suppliers or customers, or as owners or partners in a joint venture, provide many opportunities for cooperation and may substantially lessen competition despite a large number of participants. The strategies generally fall into three categories: mergers, joint ventures and protective tariffs. It is important to note that mergers and joint ventures may well achieve both pro-competitive goals (e.g. sharing technology, access to capital) and competition-reducing ones

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[7] *Financial Times* (2002).
[8] Levenstein and Suslow (2001).

(e.g. the cartel accommodates new entrants on its own terms). Following the demise of the cartels studied, cartel participants entered into joint ventures with one another and with firms based in developing countries. This raises the question whether competition authorities are lax or wanting in their vigilance regarding former price-fixers. It also raises the question whether this laxity is in part due to their not having a mandate to act in the interests of third markets. There are a number of instances where United States and European competition authorities have uncovered evidence that private international cartels have affected developing country markets. However, this information could not be shared with these countries because of legal constraints (the majority of developing countries do not have competition-related cooperation agreements with either the United States or the European Union).

17. The above underlines the need for competition policy enforcement authorities to ensure that cooperation does not lend itself to anti-competitive behaviour by merged or networked firms, while at the same time not hindering innovation and thus competition and competitiveness. Moreover, it underlines the need for a case-by-case analysis of mergers and joint ventures. The use of protective tariffs through anti-dumping complaints by domestic producers is one tactic that authorities in developed countries are increasingly wary of. Recourse to anti-dumping action has also been observed in developing countries, notably against imports from other developing countries. This raises the question whether trade officials in developing countries are in a position, in every case, to take into account possible anti-competitive objectives behind domestic producers' anti-dumping suits – particularly where the country does not have a competition policy or competition authority.

18. The competitiveness of firms in developing countries is severely constrained by poor and inadequate economic infrastructure. The lack of technological infrastructure, in terms of knowledge-creating institutions and business development services, and problems with access to technology are major obstacles to firms' ability to innovate. Acquiring technological capabilities is not an automatic process in response to market signals. It is a costly and invariably time-consuming process very much dependent on country-specific factors that influence the ease and cost of the upgrading process and the time it will take. It can be prolonged and uncertain – particularly in developing countries, where firms tend to face widespread market and institutional failures.

19. Since new technology and ideas are at the heart of innovation, which is the key source of dynamic competitiveness, intellectual property becomes a primary asset of the firm and plays a major role in competitive strategy. By minimizing the risks associated with innovation and allowing innovators to amortize investments made in the research that led to their innovation, intellectual property protection provides a stimulus for creativity. However, it effectively grants limited monopoly rights in respect of technical elements that may be critical to the development, in the future, of products in a number of markets, and as a result can be a source of anti-competitive practices. For example, there is evidence that some of the cartels prosecuted by the United States and the European Union attempted to restrict information about technology. The expansion and strengthening of intellectual property protection in developed countries have taken place in tandem with the effective application of competition law to remedy anti-competitive practices. This has not been the case in many

developing countries, where competition law is non-existent or very weak in this respect. South Africa has had some success in this area, which illustrates how the application of competition policy may take into account intellectual property rights. For example, in evaluating the merger between Glaxo Wellcome PLC and SmithKline Beecham PLC in the pharmaceutical industry in South Africa, the South African Competition Commission considered the intellectual property rights held by these companies, and this resulted in orders for the divestiture or licensing out of some of those that were near expiration.[9] This raises the question whether and how the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property Rights could be made to better accommodate developing countries' competition and development concerns as an increasing number of commentators (including the World Bank[10]) are advocating.

20. Developing country firms are furthermore disadvantaged not only by a lack of domestic suppliers but also by the means available to get their products to market. Numerous impediments prevent investments in technology, human resources and improvements in the efficiency with which resources are used throughout the economy. Moreover, competition in the transport and communications sector, the financial sector and the insurance sector, key supporting sectors for producers and exporters, is limited if not totally absent. They experience long delivery times, problems with financing, difficulties in managing risk and high transport and communication costs. These problems are compounded by a lack of skills in investment, production and marketing.

21. The lack of competition and the poor quality in supporting sectors limit the capability of domestic firms to adapt and meet the challenges of international competition. In particular, high transport costs feed into import and export prices. With increased competition forcing firms to adapt to just-in-time production and management systems, flexibility, speed and reliability regarding the delivery of goods have assumed significant strategic importance and are a key source of dynamic competitiveness. For instance, because of unreliable and infrequent transport services or the lack of third-party logistics providers who can efficiently handle small shipments, inventory holdings in the manufacturing sector in developing countries are two to five times higher than in the United States. It is estimated that cutting inventory levels in half could reduce unit costs (and free up scarce capital) of production by over 20 per cent.[11] Anti-cartel action by the European Commission in the shipping sector has led to reduced freight charges and better service on the transatlantic and Europe–Asia shipping routes, and to a lesser extent on the Europe–West Africa ones.[12] However, particularly for Africa, inland transport (rail/road) is by far the most expensive. Inadequate and poorly maintained secondary and tertiary transport networks undermine national efforts to engage in regional and international trade. Moreover, landlocked countries are at an acute disadvantage. For example, the price quotes for container shipments from Baltimore (United States) reveal that the cost of shipment to Durban (South Africa) is US$2,500, whereas the

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[9] UNCTAD (2002).
[10] World Bank (2002).
[11] World Bank (2002).
[12] Thin traffic densities have prevented freight charges from falling by as much as on the Europe–Asia routes.

cost of shipment to Mbabane (Swaziland) via Durban is US$12,000 – a landlocked "penalty" of 380 per cent.[13]

22. Clearly, issues related to competition explain many of the problems facing developing country firms in their pursuit of competitiveness. Even with regard to transport and communications positions, hauliers or multimodal transport service providers often have significant market power (often as a result of the small size of markets) in local markets and in many cases the State may be the only player. For example, complaints were made to the Venezuelan competition authority that Compañía Anónima Nacional de Telefonos de Venezuela (CANTV), which had a monopoly position in the provision of basic telecommunications services, was imposing discriminatory commercial conditions on other value-added services Internet providers relative to those granted to its own subsidiary. CANTV was duly instructed to offer similar commercial conditions to all Internet service providers, as well as to make available interconnection numbers to enable them to access local loops at the cost of a local telephone call. The role of competition law and policy is obvious in such cases. However, competition policy alone is not enough. Complementary policies to induce industrial restructuring, in addition to trade and investment liberalization, are necessary. Clearly, if firms are to meet the challenges of competition by identifying new opportunities, inducing innovations so as to effectively exploit these opportunities and minimize marketing and technology development costs through networking and forging ties with other firms, there is a need for a coherent policy environment which links macroeconomic and sectoral policies with firm-level efforts to attain and maintain competitiveness. More importantly, there is a need for a systemic approach to facilitating competitiveness.

[13] World Bank (2002).

III. HOW COMPETITION LAW AND POLICY ADDRESSES ANTI-COMPETITIVE PRACTICES IN A DEVELOPING COUNTRY AND ITS RELEVANCE TO DEVELOPMENT

23. Standard economic theory tells us that competitive forces work best and deliver the expected outcomes when there exists a market that is not overridden by distortions arising from market failure. As already illustrated in preceding sections, in most developing countries, local firms are constrained in their ability to respond to competition and the benefits of enhancing economic efficiency may not necessarily always be pro-competitiveness and pro-development. The existence of a free market system by itself is a necessary but not a sufficient precondition for national and international competitiveness. These inconveniences, and the current wave of globalization-induced mergers and acquisitions, which individually and collectively may have a negative impact on economic development, make it necessary more than ever for developing countries to have competition policies.

24. Anti-competitive practices tend to be less prevalent in economies where the effective use of national competition law and policy acts as a deterrent. Competition policy can protect producers and consumers from anti-competitive practices which raise costs and prices and reduce production, while at the same time promoting transparency and enhancing the attractiveness of an economy to foreign investment, and can also reinforce and maximize the benefits of such investment. Since competition policy and legislation is applied to all firms operating in the national economy, in addition to disciplining local firms it ensures that FDI does not bring with it restraint of trade or abuses of market power. An important part of competition policy is its advocacy function, which helps to impart a culture of competition in the manner in which firms interact in the economy and can in itself foster increased adherence to competition principles and encourage self-discipline amongst firms, thus reducing production and enforcement costs.

25. There is now a convergence of views on the fact that competition policy should take into account the stage of development and structure of an economy. Competition policy in developing countries should therefore be expected to emphasize dynamic as well as static efficiency as a major concern for economic development. Moreover, given that market concentration is likely be a significant problem in many cases, solutions will have to be sought to allow for an optimal degree of competition, and take due account of the need for coherence between broader developmental goals and pure efficiency goals. Hence, in developing countries competition policies tend to be defined in broad terms to include all national policies that are aimed directly at increasing competition in markets, including deregulation, privatization, international trade, FDI and intellectual property. The economic situation of many developing countries may dictate that broader social objectives be built into the goals of competition policy. For example, South African competition policy, which takes into account the issue of "black empowerment", is an illuminating case in point. Policy coherence between competition policy and industrial, trade and investment policies is also crucial. In some cases, countries encompass elements of industrial and investment policy within their competition policies in order to address issues of policy coherence. Thus, competition policy can be hostage to wider social considerations that may be of lesser

importance or excluded from competition policy objectives in more developed economies. This renders the implementation of competition law and policy a far more complicated balancing act in developing countries. The United Nations Set of Principles and Rules on Competition allows for the flexible application of competition law and policy in recognition of broader developmental goals.[14]

26. To be effective, competition law and policy in developing countries and economies in transition will require periodic amendments and improvements in the light of market development and evolution, as is the case in developed countries. For example, the Indian, Kenyan, Tanzanian and Thai competition laws are currently under review in the light of market developments and demands related to interpretation and enforcement concerns.

[14] See, in particular, paragraph 7, section C, of the Set.

IV. FACILITATING COMPETITIVENESS

The role of FDI

27. FDI is one means by which developing countries may cover shortfalls in domestic capital accumulation and gain access to technology, skills and managerial know-how. It can have positive benefits in terms of increasing the contestability of host markets, improving the performance of local industry and lowering prices. It may contribute directly to the competitiveness of local firms by being the vehicle by which they penetrate international production and marketing networks. The evidence would suggest that efficiency-seeking FDI rather than market-seeking or natural-resource-seeking FDI yields the greatest improvements in local firm competitiveness and market shares.[15] In this context, the need for local firms to incorporate themselves into international production systems, particularly those of manufactures involving high and intermediate levels of technology, is important. Singapore is perhaps the most celebrated case of technological upgrading via FDI and has achieved impressive export-led growth rates, ranking as the world's most competitive economy in 1995. By directing FDI inflows into higher-value-added, high-tech activities, Singapore rapidly evolved from assembly based on cheap labour to advanced automated manufacturing. In sub-Saharan Africa, Mauritius is probably the most notable case and has enjoyed considerable success in attracting FDI in manufactured products and altering the structure of its competitiveness. In the 1990s, the main recipient of FDI from the newly industrializing economies was China, now by far the largest exporter of clothing and other low-technology products amongst developing countries. Other important recipients of FDI in this group of economies were Bangladesh, Indonesia, Malaysia, the Philippines, Sri Lanka and Viet Nam. European transnational corporations (TNCs) have been an important driver of labour-intensive production in North Africa. TNC activity in medium and high technology is far more concentrated than in low-technology assembly. This concentration is a function of the local technological capabilities, with higher-technology FDI going to locations where local firm capabilities are better developed. In general, the evidence indicates that in countries that are technologically weak, the extent of technology transfer by TNCs is correspondingly weak. In these cases, TNC subcontracting of local firms is confined to relatively simple components, with little transfer of technology apart from assistance with quality control techniques and minor adaptations. Joint venture arrangements also tend to be in low-technology, low-value-adding manufacturing. Where the technological and absorptive capacity of the local firm has been high, experience shows that some transfers of product and process technologies of high precision and good quality to local subcontractors have occurred.[16] The main developing countries that have attracted FDI in these sectors in Asia are Malaysia, the Philippines, Singapore and Thailand, and Mexico and Costa Rica in Latin America.[17]

28. The realization of the potential benefits of FDI depends critically on the initial conditions in the local market. FDI cannot substitute for domestic effort. If there are no local

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[15] Mortimore and Peres (2001).
[16] UNCTAD (1999b).
[17] WIR (1999).

firms with which TNCs can interact, there can be no transfer of knowledge and technology and there are unlikely to be any changes to the host economy's dynamic competitive advantages. This suggests that achieving a more widespread diffusion of TNCs' technologies and creating interlinkages with local firms requires specific interventions (e.g. SME development, entrepreneurial skills development, support for R&D and the provision and upgrading of economic infrastructure) to promote local capacity development. There are large gaps in the competitive strength of foreign affiliates and local firms in the majority of cases and studies of FDI in developing countries tend to confirm that they often have market power in their respective industries and limit domestic firms to lower-value-added activities in the industry which are vulnerable to low-cost competition.[18]

29. FDI statistics suggest that mergers and acquisitions (M&As) contribute an increasing share of FDI. This makes it imperative for developing host countries to understand the forces driving M&As and the impact they have on development. Perhaps the most common concern about cross-border M&As is their impact on domestic competition.[19] The case of a merger in the beverages industry in Kenya contained in the recent compilation of competition cases in developing countries carried out by UNCTAD[20] illustrates how FDI can have effects on competition within national markets. Several complaints have been made to the competition authority in Kenya about the practices of the Kenyan subsidiary of Coca-Cola International. Kenya barred the combined efforts of the local Coca-Cola subsidiary and that of South Africa to strengthen and sustain Coca-Cola's dominance in the soft drinks market by taking direct control of production, marketing and supply of inputs in all domestic plants bottling its beverages.

The role of exports

30. Export growth can be an indicator of competitiveness. For successful East Asian economies, for example, a key inducement to effect the restructuring process and stimulate learning and international competitiveness was the exposure of domestic firms to international markets through export promotion. There is some evidence to suggest that export promotion (rather than import liberalization) may be the greatest source of dynamic competitiveness.[21]

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[18] This outcome is a result both of the specialization required by the new mode of competition and of the fact that when the technological capability gap between the foreign affiliate and local firms is too large the possibilities for performance-enhancing spillovers (i.e. technology transfer) are diminished.
[19] WIR (2000).
[20] UNCTAD (2002).
[21] Mytelka (1999).

Liberalization and dynamic competitiveness

The last 20 years have seen a remarkable expansion of manufactured exports from developing countries. In this group are some of the most populous countries in the world – China, India, Indonesia and Pakistan. At the same time there are a large number of countries whose entry into manufactured export trade has been limited and sporadic. All the sub-Saharan economies are in this group, as are most Latin American countries.

Countries which have had high growth rates for manufactured exports and which have therefore been defined as internationally competitive do not necessarily owe their competitiveness to technological factors. Countries with high export growth and low productivity – such as Mauritius and Sri Lanka – have focused their export development on sectors in which they have established strong static comparative advantages. Latin American countries show similar patterns, usually associated with natural-resource-based industrialization. Other countries, for example the Republic of Korea and Singapore, along with China, India, Indonesia, Malaysia, Pakistan and Thailand, may be described as being on a high productivity growth path and having dynamic comparative advantages.

Obviously, most countries, even the most technologically advanced, show features of both low and high productivity growth. However, the notion of distinctive growth paths reflects an important reality. The majority of developing countries that have not experienced export growth in a significant way show little sign of growth of productivity in manufacturing.

While a few developing countries have come to export a wide variety of products, most have concentrated on labour-intensive or natural-resource-based products, including low-technology inputs to the electronics industry. There is growing concern that such low-technology manufactures are beginning to acquire the features of primary commodities in world markets, facing a secular downward trend as well as the dilemma of fallacy of composition.[22]

The decline in the terms of trade of developing countries' manufactured exports since the mid-1980s shows how important it is, in pursuing policies of export diversification, to promote industries that have a scientific and technological content. The decline in the manufacturing terms of trade of developing countries was found to be largest for the least developed countries and smallest for the East Asian newly industrializing economies, indicating the key role of scientific and technological development in stimulating upward movement on the value ladder.

Source: Extracted from Cooper (1995) and TDR (1999).

31. Developing countries are among those that have benefited from improved export performance (see text box above). Much of this export success is a direct consequence of trade liberalization and the adoption of market-friendly reforms. However, one main concern is that most of these countries have not been able to reduce their dependence on exports of primary products. There is no conflict between exploiting static sources of comparative advantage (as developing countries have been doing quite well) and developing new, dynamic ones. Existing advantages can provide the means by which new advantages can be developed. Many developing countries appear to be having difficulty with the latter. Many of the reasons for their difficulty in capitalizing on their initial export successes have already been discussed. Markets and other institutions needed for the efficient functioning of a market economy were often missing or highly imperfect when these countries embarked on trade liberalization and adopted free-market-based principles. Insufficient attention to

[22] The fallacy of composition argument states that if a large number of developing countries pursue the same strategy (i.e. resource-based export promotion) simultaneously, any gains in volume under conditions of low elasticity of demand will be eroded by price declines. There is some evidence that the relative price of manufactured exports from developing countries has fallen over the last two decades alongside the rapid expansion of their volume. See TDR (1999: 133).

domestic competition issues has, in some cases, negated whatever positive effects may have been gained from liberalization and privatization. As noted above, in the international arena, anti-competitive practices can restrict access to markets for exports from developing countries and prevent them from developing further export capacity. In such conditions, initial weaknesses and asymmetries in supply capabilities are as likely to be reinforced as removed by closer integration into world markets. Firms may appear competitive in terms of their export performance as a result of currency devaluation, but this apparent competitiveness will not result in an economy's growth and development because currency devaluation reduces living standards by increasing costs of imports and worsening terms of trade. Countries whose comparative advantage is vested in low-wage unskilled labour can find themselves locked in a contest with other countries for footloose FDI.

V. POLICY IMPLICATIONS

32. From the above discussion, the positive interaction between competition, competitiveness and development seems to be indisputable. However, in the real world, and particularly in developing countries and economies in transition, the presence of market failures blunts the impact of competitive forces and leads to departures from the model of perfect competition. The perverse effect that market failures can have on competitive forces would seem to be particularly serious for dynamic competitiveness. Under dynamic competitive conditions the relationship between competition and competitiveness is much more complex.

33. In reality every economy, including the most developed, has firms that operate profitably and make a meaningful contribution to economic growth on the basis of static competitiveness. However, in recent years, not only has the scope of competition changed but also its nature, and an economy that is able to adjust to changing conditions is one that is characterized by a variety of different industries, some of which encompass a reasonable number of high-value jobs. With liberalization and globalization, firms compete not only on price but also on the basis of their ability to learn, adjust to market conditions and sustain a process of innovation.

34. In most developing countries, the conditions for perfect competition are far from being met and the benefits of enhanced economic efficiency do not necessarily always materialize. Developing countries should adopt an appropriate strategy of liberalization and integration into the global economy, taking proper account of the need to ensure the existence of conditions for workable competition in their economies and the determinants of sustained competitiveness in an increasingly knowledge-intensive world economy. A comprehensive approach to liberalization is needed in order to establish an enabling environment for firms to compete effectively, including the development of physical and technological infrastructure.

35. Competition law and policy is a vital tool for the achievement of systemic competitiveness in a globalizing world economy in which competition is characterized by a fierce struggle to be the next temporary monopolist (through technological innovation). Recognition that developing markets are fraught with market failures that could impede or dilute competitive forces and result in perverse outcomes to competition makes putting in place a policy framework for workable competition a necessity. A comprehensive approach to liberalization should encompass the establishment of complementary competition policy to ensure that instances of market power do not erode the competition and other benefits that result from liberalization. Consequently, when countries put in place a package of "competitiveness policies", competition policy should rank high alongside investment, industrial and trade policies.

36. There is a tendency in the current trends in global competition towards concentration of economic and market power. This tendency has increased the need for, and the importance of, competition policy in both developed and developing countries.

37. The fact that the new mode of competition requires firms (particularly in developing countries) to undergo a lengthy and costly process of learning and technological upgrading, and that abrupt liberalization may be counter-productive with regard to attaining international competitiveness, constitutes a compelling case for special and differential treatment for developing countries in matters regarding a possible multilateral framework on competition.

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